APPENDIX B

TREASURY MANAGEMENT STRATEGY STATEMENT 2023-24

Introduction

1. Treasury management is the management of the authority's cash flows, borrowing and investments. The council is exposed to financial risks from treasury management activity including possible losses associated with council investment and potential for increased borrowing costs arising from market movements. The identification, monitoring and control of financial risks are a crucial part of the financial management and governance arrangements of the council.

2. Treasury risk management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the council to approve a treasury management strategy before the start of each financial year. This report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3. Investments held for service purposes or for commercial profit are considered in the Capital Strategy.

4. Under financial delegation, the strategic director of finance and governance is responsible for all executive and operational decisions on treasury management. This treasury management strategy, together with supporting prudential indicators and policies will ensure that these responsibilities can be carried out effectively.

Net Borrowing Position

5. As at 30 September 2022, the council held £888m of borrowing and £198m of investments.

Borrowing strategy and debt management activity and position

6. The council has an ambitious capital programme, both to support the wide range of services it offers but also to build much-needed new council homes. In the past, revenue balances have been utilised to forestall the need to borrow externally. This approach is commonly known as internal borrowing. Internal borrowing is cheaper than external borrowing and remains the preferred source of financing in the short term whilst sufficient funds are available.

7. However, in September 2017, officers reported to cabinet that from 2017-18 onwards there would be an increasing need to borrow externally. Since then, external borrowing has gradually increased, both as a proportion of capital funding and in absolute terms. This has been necessary because of the scale of the capital programme.

8. Southwark has the 10th highest outstanding PWLB debt of all English councils. This is largely as a consequence of the size of Southwark's council housing estate and its position as the 4th largest social landlord in the country. This ranking is likely to rise based on the additional borrowing that will be required in coming years to fund the capital programme.

9. The most significant part of that programme remains new homes. To date, approximately £226m of external borrowing has been taken to fund the New Homes Programme and a further £674m has been previously earmarked as the sum that could be borrowed within prudential code and affordability limits. This amounts to £900m in total for new homes. This provision is being constantly reviewed, especially in the context of interest rate rises, rent caps and inflation.

10. The need to borrow externally has a revenue impact, and this is accounted for annually in the council's budget setting process, both for the Housing Revenue Account and the General Fund.

11. The PWLB remains the cheapest and most efficient source of external debt and the current strategy prioritises this over alternative funding sources which frequently incur additional unseen overheads including management fees, administration costs and balance sheet complexities which reduce transparency. Officers seek to ensure that the entire cost of borrowing is taken into account and that best value for money is achieved for taxpayers.

12. The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

    Whilst internal borrowing and short-term borrowing provide a low cost interim solution, they effectively defer inevitable long term borrowing into subsequent periods. As interest rates are rising (and forecast to do so for some time), the strategy for 2023-24 is to borrow externally when rates are favourable to mitigate the risk of being forced into borrowing at even higher rates in future. The exact timing and amounts will be determined by the Strategic Director of Finance and Governance and with regard to advice from our external treasury advisors.

Liability Benchmark

13. To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-today cash flow.

14. CIPFA recommends that the optimum position for external borrowing should be at the level of the Liability Benchmark (i.e. all balance sheet

resources should be used to maximise internal borrowing). If the outputs show future periods where external loans are less than the Liability Benchmark, this indicates a borrowing requirement thus identifying where the Authority is exposed to interest rate, Liquidity and refinancing risks. Conversely, where external loans exceed the Liability Benchmark, this will highlight an over-borrowed position which will result in excess cash in the organisation requiring investment, thus exposing the Authority to credit and reinvestment risks and a potential cost of carry.

From the table below, this Liability Benchmark requires that cash and investment balances are kept to a minimum level of £140m at each year-end. This amount includes the Council's external fund managers' portfolio of £100m, and an internally managed cash balance of £40m, to maintain sufficient liquidity. The risks identified will then have to be managed over the coming years.

	Liability Benchmark £m	**2021-22 Actual**	**2022-23 Estimate**	**2023-24 Estimate**	**2024-25 Estimate**	**2025-26 Estimate**
1	HRA CFR	609	820	1,102	1,250	1,320
2	General Fund CFR	754	821	919	926	930
3	**Total CFR** *(Line 1+2)*	**1,363**	**1,641**	**2,021**	**2,176**	**2,250**
4	Less: Other long-term liabilities	81	81	76	71	66
5	**Loans CFR** *(Line 3+4)*	**1,282**	**1,560**	**1,945**	**2,105**	**2,184**
6	Less: External Borrowing	896	851	828	804	779
7	**Internal Borrowing / (Over Borrowing)** *(Line 5+6)*	**386**	**709**	**1,117**	**1,301**	**1,405**
8	Less: Usable reserves	372	322	297	272	247
9	Less: Working capital	175	265	265	139	70
10	**(Investments)/New Borrowing** *(Line 7-8-9)*	-161	122	555	890	1,088
11	**Net Borrowing Requirement** *(Line 10-6)*	735	973	1,383	1,694	1,867
12	Minimum Investment Balance	161	140	140	140	140
	Liability Benchmark: Year-End *(Line 11+12)*	**896**	**1,113**	**1,523**	**1,834**	**2,007**

15. The liability benchmark suggests the Council will require a minimum level of borrowing in 2023-24 of £410m to maintain the minimum investment level of £140m at year-end. The actual level of borrowing at year-end depends on whether the council's spending plans proceed as planned and on the actual timing of borrowing.

Investment Position and Activity

16. The council holds sizeable investment balances, representing income received in advance of expenditure plus balances and reserves held. Investments as at 30 September 2021 were £143m.

17. Council resources that are not immediately required for current expenditure are invested in money market instruments in accordance with the MHCLG (now the Department of Levelling Up and Housing and Communities (DLUHC) Guidance on Local Authority Investments and the council's approved investment strategy. The guidance gives priority to security and liquidity and the aim is to achieve a yield commensurate with these principles.

18. Council investments are managed both in-house and delegated to two fund managers: Alliance Bernstein and Aberdeen Standard (formerly Aberdeen Asset Management). The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds and other highly secure, liquid financial instruments

19. Any surplus cash resources not required in the short-term to fund council activities is placed with the council's two external fund managers. The fund managers invest for a longer term in UK government gilts, supranational bank bonds, certificates of deposits issued by major banks/ building societies and other financial instruments.

20. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

21. The distribution of council investments across counterparties by rating and maturity as at 30 September 2022 is set out in the table below:

	A		**AA**		**AAA**		**Total**	
Investment Maturity	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to 1 Year	55.4	28.0	48.8	24.7	82.7	41.8	186.9	94.5
1-2 Years	1.5	0.7	0.1	0.1	3.5	1.7	5.0	2.5
2-5Years	1.9	1.0	0.2	0.1	3.9	1.9	5.9	3.0
Total	**58.7**	**29.7**	**49.1**	**24.8**	**90.0**	**45.5**	**197.8**	**100.0**

AAA represents the highest credit quality, AA represents very high credit quality and A represents high credit quality.

22. On 4 November 2022, the Bank of England increased the base interest rate from 2.25% to a 14-year high of 3.00%. It sent the strongest signal yet that it thinks rates will not need to rise much above 4%. However, with price/wage expectations still elevated (with inflation currently above 11%) there is potential for rates to continue upwards.

23. The Authority's treasury management adviser Arlingclose is forecasting the Bank of England Bank Rate to peak at 5% in March 2023 and then stabilise.

24. To analyse the treasury management portfolio, the council measures the return against a composite investment benchmark of three-month SONIA and one to three year gilt index.

25. The rate of investment return generated by the treasury management portfolio is a consequence of the council's prudent, low risk approach to treasury management investing. This is in line with the requirements of the statutory guidance for local government treasury investment issued by MHCLG (now DLHUC)

26. The priorities for treasury management investment are, in order of priority, security, liquidity and yield. The objective therefore is to ensure that funds are available to meet council liabilities as they fall due.

27. It is important that the treasury management strategy is suitably flexible such that the council can take advantage of market opportunities and maintain appropriate asset diversification within the portfolio to best support the council's revenue budget, whilst retaining the overriding objectives of security and liquidity.

28. The 2022-23 investment strategy, agreed by Council Assembly in February 2022 allowed for sufficient flexibility in the implementation of the investment strategy for the council such that there is no requirement to change it further at this time.